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No. 84-1944

In The
Supreme Court of the United States
October Term, 1984

UNITED STATES OF AMERICA, ET AL.,
Appellants,

v.

ALVIN HEMME, ET AL.,
Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF ILLINOIS

MOTION TO DISMISS ON BEHALF OF ALVIN HEMME, ET AL., OR, IN THE ALTERNATIVE, MOTION TO AFFIRM

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RESTATEMENT OF QUESTION PRESENTED FOR REVIEW

Appellees respectfully disagree with the appellant's statement of the question presented for review. The question presented below is a more factually accurate statement which will emerge from examination of the record below.

Where a decedent made gifts on September 28, 1976 and elected to apply the $30,000 specific exemption against the same, can a reduction of $6,000 in the unified credit pursuant to Internal Revenue Code Section 2010(c) which was amended on October 4, 1976 (when the President signed it into law), constitutionally be made when the same gifts were included in the decedent's gross estate as transfers made in contemplation of death pursuant to Section 2035, as amended?

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Appellants,[1]

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ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF ILLINOIS

MOTION TO DISMISS ON BEHALF OF ALVIN HEMME, ET AL., OR, IN THE ALTERNATIVE, MOTION TO AFFIRM

[1]Appellants are: United States of America, Department of the Treasury of The United States of America and Commissioner of Internal Revenue.

[2]Appellees are Alvin Hemme, Dennis Hemme, Ron Hemme and Farmers and Merchants Bank of Highland, a corporation, as Trustee of the Revocable Living Trust of Charles W. Hirschi.

STATEMENT AS TO THE RESTATED ISSUE RAISED BY APPELLANT

The appellees have chosen to restate the issue raised by the appellant in conformity with Rule 15.1(a) of this Court. (Motion to Dismiss on Behalf of Alvin Hemme, et al., or, in the Alternative, Motion to Affirm p. i).

The appellant has made three misstatements of significant facts in his Jurisdictional Statement which must be called to the attention of the Court.

The appellant has misstated the holding of the district court (Appellant's Jurisdictional Statement, p. 2) in the following language:

> "The district court held that this transitional rule was a species of retroactive legislation and that it was so arbitrary and capricious as to render it unconstitutional under the Due Process Clause of the Fifth Amendment."

In reality, the district court held (Appellant's Jurisdictional Statement, Appendix A, p. 6a):

> "Accordingly, we hold the tax under Section 2010(c) *as applied to this transaction* is so arbitrary and capricious as to render it unconstitutional." (Emphasis added.)

The district court did not hold the transitional rule unconstitutional in all events but only as it applied to *this transaction*. The district court narrowly limited its holding to the facts on this case only.

Two additional misstatements by the appellant appear in footnote 7 on page 9 of its Jurisdictional Statement:

> "Appellees' statutory argument had been squarely rejected in *Estate of Renick v. United States*, 687 F. 2d

371 (Ct. Cl. 1982), and the *court below did not consider it.*" (Emphasis added.)

The *Renick* plaintiff's statutory interpretation argument in *Estate of Renick* and the appellees' statutory interpretation argument herein are substantially different. The arguments which the Renick Estate presented and which the *Renick* court rejected were avoided by the appellees in the instant case. Appellees raised new and additional statutory interpretation arguments herein which the *Renick* court did not have before it, and could not, therefore, pass upon and certainly has not rejected as the appellant has tried to lead us to believe.

Furthermore, the district court specifically referred to the *Renick* case four times and quoted from it once. (Appellants' Jurisdictional Statement, Appendix A, pp. 5a-6a). The district court decided the case on the constitutional issue, however, and had no need to decide the issue of statutory construction. The issue of statutory interpretation was raised and was thoroughly briefed and argued before the district court. The district court had the issue before it. In light of these overwhelming facts, it is an utter falsehood for the appellant to say that "the court below did not consider" the appellees' statutory interpretation argument.

NUMEROUS FACTORS MUST BE CONSIDERED IN DETERMINING WHETHER THE QUESTION IS SUBSTANTIAL

The greatest possible extension of this case is only to those persons—

(1) who made gifts between September 9, 1976 and October 3, 1976, both dates inclusive, (a period of 24 days)

(2) who filed their gift tax returns before October 4, 1970 and

(3) elected thereon to use a part or all of their $30,000 specific exemption under Section 2521 against such gifts,

(4) then had the misfortune to die within three years of the date those gifts were made, and

(5) who left estates which were taxable and

(6) had those gifts (or transfers) included in their estates as transfers in contemplation of death.

All of those persons

(7) would have died by October 3, 1979, and

(8) the last of the federal estate tax returns on their estates would have been due on July 3, 1980,

(9) with the Statute of Limitations (Section 6501) on those returns expiring on July 4, 1983, which was over two years ago.

No other reported case contains these facts. Only one other case (involving a gift made on December 31, 1976) *Estate of Renick v. United States,* 687 F. 2d 371 has been reported, but its facts are distinguishable from the instant case. Although the attorney for the appellees has one other case now pending in the United States District Court for the Southern District of Illinois with facts more analogous to those in *Renick* than to those in the case at bar (gift made on October 20, 1976, gift tax return filed in December 31, 1976), it likewise is distinguishable from the instant case. At this late date it is highly unlikely that

any other cases are still pending with facts analogous to those of the case at bar.

The total amount of estate tax involved in this case is $6,000.

The appellant admits that "the statute involved is a relatively obscure transitional rule." (Appellant's Jurisdictional Statement, p. 10). Furthermore, the reasoning of the district court is very restricted. In fact, it is limited to the facts of this case only. It would not disable Congress from enacting amendments to income tax laws containing retroactive features, as the appellant says, for the district court specifically noted that this court has held that Congress may provide for the retroactive operation of income tax legislation (Appellant's Jurisdictional Statement, Appendix A, p. 3a). Likewise the reasoning of the district court would not disable Congress from enacting amendments to estate and gift tax laws containing retroactive features, as the appellant asserts, for the district court recognized that "(t)here have been cases where a retroactive tax on an estate and gifts has been upheld." (citing cases.) (Appellant's Jurisdictional Statement, Appendix A, p. 5a). The district court then distinguished the *Milliken v. United States*, 283 U.S. 15, and *Estate of Renick v. United States*, 687 F. 2d 371, from the instant case.

The appellant is "crying wolf" when he says "The decision below thus threatens to affect adversely the administration of the revenue by circumscribing what had heretofore been regarded as the unquestioned prerogative of Congress in enacting tax statutes." (Appellant's Jurisdictional Statement, p. 10) The judgment of the district court states quite the contrary.

1. The district court properly held that the transitional rule of Section 2010(c) was so arbitrary and capricious as to violate the prohibition against depriving any person of property without due process of law contained in the Due Process Clause of the Fifth Amendment.

The appellant cleverly argues that by reason of the enactment of the Tax Reform Act of 1976 the decedent's estate would have saved $655.16, and, therefore, the decedent's estate had not been deprived of property. (Appellant's Jurisdictional Statement, pp. 10-11). The Tax Reform Act indeed reduced the decedent's estate tax by $655.16, but the appellant ignores the fact that the effect of the Tax Reform Act was to tax the same property of the decedent two times or to double the estate tax on that property (or transfer). The decedent died on November 9, 1978. His death occurred within three years of the date on which he made the above gifts. An estate tax return was timely filed and the gifts made on September 28, 1976 were reported and included as transfers made in contemplation of death under Section 2035. In addition, pursuant to Section 2010(c), which was signed into law on October 4, 1976, an adjustment of $6,000 (20% of the $30,000 specific exemption) was made reducing the amount of the unified credit alowable on the decedent's estate tax return. As a result of this adjustment, the decedent's estate received only a $28,000 unified credit ($34,000 minus $6,000) rather than the full $34,000 unified credit applicable to estates of decedents dying duing 1978. The effect of the Appellant's interpretation of these two sections of the Internal Revenue Code is to tax the same property (or transfer) twice or to double the estate tax on that property (or transfer). The appellant tries to cover up the fact of

double taxation in this case by arguing that congress did not extend to the Hirschi estate the "double tax benefit" which it gave to other persons who claimed the specific exemption on gifts made before September 9, 1976. (Appellant's Jurisdictional Statement, p. 11). No doubt what the appellant refers to is 1) the estate tax reduction of $655.16 resulting from the changes in the Tax Reform Act of 1976 over the prior law and 2) the granting to pre-September 9, 1976 donors (and to post-September 9, 1976 donors who did not elect to use any part of their specific exemption) an additional $6,000 unified credit on death, but the appellant does not explain. As a matter of fact, Congress did not give a "double tax benefit" to all such persons, because they were still subject to the "transfers in contemplation of death" rule of Section 2035. Section 2010(c) enacted on October 4, 1976 effectively deprived the appellees of property by taxing that property twice, once under Section 2010(c) and again under Section 2035, resulting in double taxation of the same property. It is interesting to note that if the decedent had died before January 1, 1977 (the effective date of the Tax Reform Act of 1976) his estate tax would have been $6,000 less than the appellant claims, because pre-1977 law then would have applied to his estate. His estate also would not have been entitled to the $655.16 estate tax reduction resulting from the changes in the Tax Reform Act of 1976 over the law then in effect.

Appellant cites *United States v. Maryland Savings-Share Insurance Corp.*, 400 U.S. 4 (1970) an income tax case in support of its argument. Appellees do not disagree with the holding of that case as it applies to amendments to income tax laws, but, as stated above, here we are dealing with amendments to estate tax laws.

2. The application of Section 2010(c) to the appellees constitutes retroactive legislation, and the district court was correct in examining it in light of the Due Process Clause. The decedent made his gifts on September 28, 1976. Two days later (September 30, 1976) he timely filed his gift tax return reporting those gifts and electing to use the $30,000 specific exemption against them. In 1976, Section 6075(a) required the filing of decedent's federal gift tax return on or before the 15th day of the second month following the end of the calendar quarter in which the gifts were made. Since decedent's gifts were made during the July-September quarter, his gift tax return was due on or before November 15, 1976.

The district court held (Appellee's Jurisdictional Statement, Appendix A, p. 6a):

> "In the present case Mr. Hirschi had no such choice. His gift was made and his gift tax returns filed before the statute's enactment. Although the decedent taxpayer, like the taxpayer in *Untermyer*[3], may have had notice of the proposed tax he should not be required to guess on what the legislative outcome would be."

There was a possibility that the President would not sign the Tax Reform Act of 1976 into law. Although this was unlikely, this uncertainty prevailed throughout the period that the decedent made the gifts and filed his gift tax returns. The President signed the Tax Reform Act of 1976 into law six days after the decedent made the gifts and four days after he filed his gift tax returns.

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[3]*Untermyer v. Anderson*, 276 U.S. 440 (1928).

The appellant has cited *United States v. Jacobs*, 306 U.S. 363, 367 (1939) and *United States v. Manufacturers National Bank*, 363 U.S. 194, 200 (1960).

The *Jacobs* and *Manufacturers National Bank* cases are quite unlike the instant case. In *Jacobs*, the property in question was acquired by the decedent in 1909, and the estate tax was enacted seven years later (1916). The decedent died on June 17, 1924, thus giving the decedent ample time (8 years after the estate tax became law, but only 15 days after the estate tax was amended) to structure his estate so as to minimize estate taxes regarding the property in question. Nevertheless, *Jacobs* had an opportunity to change his situation. Such was not the case here. In the instant case, the decedent made the gifts. Two days later he filed his gift tax return. Four days after that the president signed the Tax Reform Act of 1976 into law. The *Jacobs* case is distinguishable from the case at bar and is not applicable here.

In *Manufacturers National Bank* the decedent divested himself of ownership of a life insurance policy in 1936, but he continued to pay the premiums thereon. In 1942 the Revenue Act of 1942 made the payment of premiums a test for including the policy proceeds in his estate. The deceased died in 1954, which was 12 years after the 1942 Revenue Act was passed, thus giving him 12 years in which to stop paying premiums on the policy. Charles Hirschi did not have 8 years or even 15 days (as in *Jacobs*) or 12 years (as in *Manufacturers National Bank*) in which to change his situation. Charles Hirschi was locked into his situation and could not extricate himself therefrom. The *Manufacturers National Bank* case is in no way analogous

to the case at bar on the issue of the constitutionality of a retroactive amendment and is not applicable here.

The appellant's argument that "the estate tax has never been limited to property owned by the decedent at the time of his death, but has always, in its original form and as variously amended, included in the decedent's gross estate property transferred or otherwise acted upon by him at some earlier time" (Appellant's Jurisdictional Statement, pp. 12-13), is really immaterial here. What the appellees object to here is the fact that the decedent in this case had made a gift of his property in reliance on the law which was in effect on September 28 and 30, 1976, and then the law was changed on October 4, 1976 and completely altered the tax effect on such gifts. Again, the decedent was locked into his situation, and he could not free himself from it. This is what the district court described as "arbitrary and capricious". (Appellant's Jurisdictional Statement, Appendix A, p. 6a.) Because Section 2010(c) is "arbitrary and capricious" as applied to the facts of this case, it violates the Due Process Clause of the Fifth Amendment.

3. The appellant cites *Milliken v. United States*, 283 U.S. 15, 21 (1931) as rejecting the proposition that retroactivity in an estate tax statute necessarily invalidates it. (Appellant's Jurisdictional Statement, p. 13).

The district court examined the *Milliken* case and said (Appellant's Jurisdictional Statement, Appendix A, p. 5a):

> "There have been cases however where a retrospective tax on an estate and gifts has been upheld . . . (citing *Milliken* and *Renick*) . . . We feel these cases are distinguishable from the case at bar.

> "In *Milliken* the court held the Revenue Act of 1918 applicable to a gift made in 1918 for estate tax purposes. This holding was based on a similarity of the two statutes. The court found the only difference between the statutes was one of tax rate. The court further noted that the decedent could have anticipated the tax."

The *Milliken* court distinguished cases like *Untermyer v. Anderson*, 276 U.S. 440 (1928) and *Nicholas v. Coolidge*, 247 U.S. 531 (1927), where "the nature and amount of the tax burden imposed could not have been understood and foreseen by the taxpayer at the time of the particular voluntary act which made the occasion of the tax." *Milliken* at p. 21.

In the instant case, it was not foreseeable that the decedent's estate would suffer a reduction of $6,000 in the unified credit (the unified credit did not exist on September 28, 1976 or on September 30, 1976) nor would have to pay an additional $6,000 estate tax on the same gifts if he died within three years of making his gift. There was no similar provision for 1) a unified credit or 2) a reduction in unified credit in the Internal Revenue Code prior to the enactment of Section 2010(c) on October 4, 1976. Furthermore, a unified estate and gift taxing system did not exist before October 4, 1976.

This lack of notice, which violates due process and taxes a transfer which was formerly exempt, also distinguishes those cases [like *Brushaber v. Union Pacific, R. R. Co.*, 240 U.S. 1, 20 (1916)] upholding retroactive income taxes. Income tax laws, while frequently changing, are certainly foreseeable. As mentioned above, Section 2010(c) is not only new. It is unique and different. It

creates a unified credit, which previously did not exist. It requires a reduction in the unified credit allowed under the statute as a result of a gift. Then Section 2035(a) requires the inclusion of the same property which constituted the transfer (gift) without making any adjustment therefor. It is a burden which could not have been understood or foreseen at the time of the transfer. It is a transfer which might not have been made, or a transfer for which the decedent might not have claimed a specific exemption, if these burdens could have been understood or foreseen at the time the gifts were made and the gift tax returns were filed.

The appellant characterizes Section 2010(c) as a "transitional rule designed to prevent taxpayers from manipulating the timing of their gifts so as to derive a double tax benefit from the shift to a 'unified' credit estate-and-gift-tax regime." (Appellant's Jurisdictional Statement, p. 14). It is obvious that the appellant recognizes that the Tax Reform Act of 1976 created a new and different "'unified' credit estate-and-gift-tax regime," which had not previously existed in the tax law. But where is the "double tax benefit" to which the appellant refers? Is it (1) the $30,000 specific exemption under Section 2010(c) (which really results in a gift tax savings of $2,250) and (2) the reduction in estate taxes of $655.16, the latter of which is asserted on page 11 of the Appellant's Jurisdictional Statement? Perhaps it is, but on the other hand, the appellant completely ignores the penalty of double taxation to which the decedent's estate is subjected by reason of 1) the $6,000 reduction in the unified credit under Section 2010(c) and 2) the inclusion of the decedent's same $30,000 gifts in his estate under Section 2035.

In the case at bar this resulted in an estate tax of $12,000 rather than $6,000. The decedent certainly could not have anticipated all of these consequences when he made his gifts and filed his gift tax return in September 1976.

The appellant lists the dates of the meetings of the House Ways and Means Committee and the Conference Committee, and while these are all significant, it should be noted that the Tax Reform Act of 1976, did not become law until October 4, 1976 when the President signed it and after the decedent had made his gifts and had filed his gift tax return.

The Appellant cites the *Darusmont* case in support of the application of the transitional rule to the appellees. Again it should be noted that *Darusmont* dealt with a retroactive amendment to the income tax law and not to the estate tax law.

4. In his final point the appellant argues ". . . the decedent in this case 'had ample advance notice' . . . of the proposed change in the tax laws," citing *United States v. Darusmont,* 449 U.S. 292 at 299, the House Ways and Means Committee action on August 6, 1976, the Conference Committee action on September 8, 1976, and the passage of the bill by Congress on September 16, 1976—all occurring before the decedent made his gifts on Septmber 28, 1976. But the appellant cites as his principal authority, *Darusmont* which involved an amendment to the income tax laws. The appellant ignores the fact that the bill was not signed by the President until October 4, 1976, an act constitutionally required before the bill became law. U.S. Constitution, Article I, Section 7. Let us assume for the purposes of argument only that the decedent had notice of

the changes in the tax laws in question. He had made his gifts. What was he to do? His quarterly gift tax return had to be filed on or before November 15, 1976. It had to be filed under the laws then in effect. But it would have ramifications beyond the then-existent tax laws and into the new tax law. These are determinations which he had to make immediately. He did not have the legal treatises upon which the appellant relies, for even J. McCord, 1976 Estate and Gift Tax Reform: Analysis, Explanation and Commentary (Appellants Jurisdictional Statement, p. 4, 7) was not published until the following year (in 1977).

The appellant justifies the retroactivity of Section 2010(c) to September 8, 1976, in order "to prevent a 'rush to the door'". (Appellant's Jurisdictional Statement, p. 16) He recognizes, as Congress apparently recognized, that individuals might make gifts in anticipation of the signing of the new tax bill. What both the appellant and Congress failed to recognize is that individuals are making gifts all of the time—some motivated by tax laws, some not so motivated and some motivated by a combination of motives, both tax and non-tax. What both of them also failed to recognize is that in 1976 gift tax returns had to be filed quarterly and that such tax returns had to be filed at the end of the then current quarter under the tax law which was then in effect. Section 6075(a). What both of them also failed to recognize is that in those July-September, 1976 quarterly gift tax returns filed before the new tax bill was signed, taxpayers, such as the decedent, would be making elections—under the old law and not the new law—because the new law was not then in effect. This is what the decedent in this case did. After the decedent had filed his quarterly gift tax return he was locked into his posi-

tion both under the old law, and, when the new law become effective, also under the new law. Under these very limited circumstances, it was harsh, oppressive, arbitrary and capricious for Congress to make Section 2010(c) retroactive to September 8, 1976.

CONCLUSION

Appellees respectfully request the Court to dismiss the Appeal, or, in the alternative, affirm the judgment of the district court.

Respectfully submitted,

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Attorney for Appellees

September, 1985